Trends and Applications of Capitalization Rates and Room Revenue Multipliers for Limited-Service Hotels

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This article provides an overview of capitalization rates and rooms revenue multipliers, as well as a summary of recent trends for these metrics and their role in the valuation of limited-service hotels. **U.S. Hotel Appraisals** and **HVS** continually track capitalization rates and rooms revenue multipliers for limited-service assets on which we consult.

Multipliers and capitalization rates are inversely related—a lower capitalization rate results in a higher value, while a lower multiplier results in a lower value.

In the case of hotels that were sold near the date of our valuation, we can derive the capitalization rate and rooms revenue multiplier by comparing historical and forecasted rooms revenue or EBITDA (earnings before interest, taxes, depreciation, and amortization) Less Replacement Reserve against the actual purchase price.

Capitalization rate (cap rate) is the rate of return on a real estate investment property based on the income that the property is expected to generate. It is calculated by dividing the property's EBITDA (earnings before interest, taxes, depreciation, and amortization) Less Replacement Reserve by its current market value or purchase price.

$$\%\ \text{Cap Rate} = \frac{\text{Net Operating Income}}{\text{Current Market Value}}$$

Derived cap rates from actual sales can then be analyzed to determine their applicability to any given hotel. For example, if an 8.0% cap rate is derived from the sale of a five-year-old hotel, and the hotel being analyzed is 25 years old, an upward adjustment for age would need to be applied to the cap rate. This is the case for any metric of comparison, such as location, brand, renovation history, historical and expected changes in income generation, and changes in market conditions. Once an appropriate cap rate is determined for a hotel, the value can be calculated by dividing EBITDA by the cap rate. A lower cap rate equates to a higher value.

$$\text{Value} = \frac{\text{EBITDA Less Replacement Reserve}}{\text{Cap Rate }\%}$$

Summary

This article provides an overview of the use and application of capitalization rates and rooms revenue multipliers in the valuation of limited-service hotels, as well as recent trends for these metrics, as researched and compiled by U.S. Hotel Appraisals and HVS.

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Rooms revenue multiplier (RRM) is a metric used to value a property based on rooms revenue. In limited-service hotels where rooms revenue comprises nearly all of the total revenue, a rooms revenue multiplier is a straightforward, easy to explain and understand method of valuation, particularly for stabilized assets. Using this method, the value of a hotel is equal to annual rooms revenue times a multiplier (RRM). The multiplier is calculated by dividing the property's purchase price by its annual rooms revenue.

$$\mathit{RRM} = \frac{\textit{Property Purchase Price}}{\textit{Annual Revenue}}$$

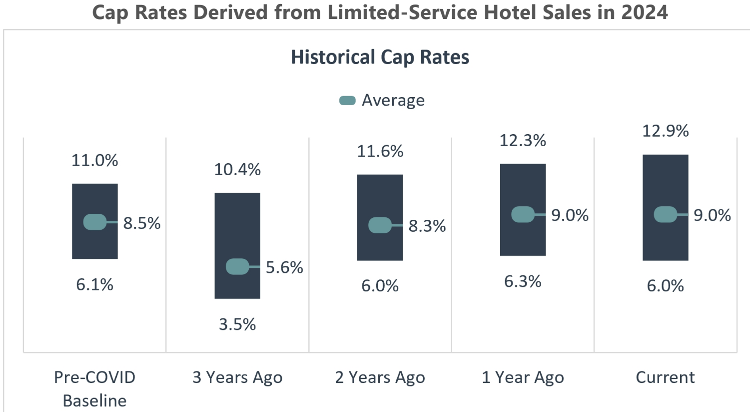
$$\mathit{Value} = \textit{EBITDA Less Replacement Reserve} \times \mathit{RRM}$$

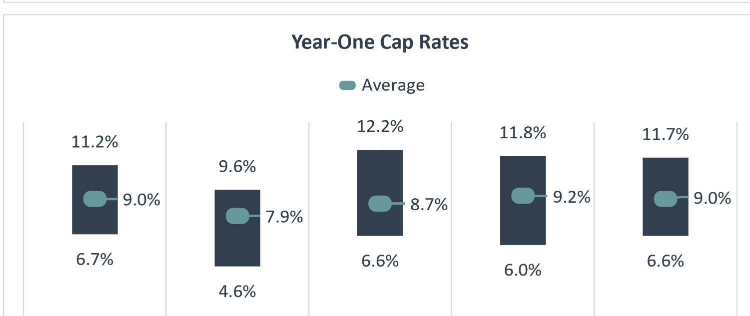
Similar to cap rates, derived RRMs must be analyzed and adjusted to determine their applicability to a specific hotel. For example, if a 4.0 RRM is derived from the sale of a five-year-old hotel, and the hotel being analyzed is 25 years old, a downward adjustment for age would need to be applied to the RRM. Similar adjustments can be made for other metrics of comparison. A lower RRM equates to a lower value.

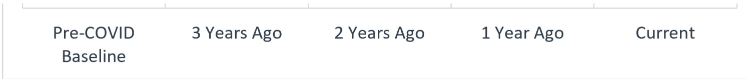
Real-World Data

A summary of recent trends for derived cap rates and rooms revenue multipliers from sales of limited-service hotels is illustrated below. We note that there tends to be a lag between the sales data and current market conditions; thus, the full effect of the recent changes in the economy and capital markets may not yet be reflected.

Cap Rates Derived from Limited-Service Hotel Sales in 2024







Source: HVS

Rooms Revenue Multipliers Derived from Limited-Service Hotel Sales in 2024

Source: HVS

Role in Valuation & Applicability

Ultimately, the multiplier and direct capitalization approaches are both limited to one year of performance in their assessment of the asset and operation. As such, significant adjustments to the capitalization rate or multiplier may be required if the hotel is not stabilized.

The RRM metric shows how efficient and profitable a hotel is, along with its capital needs and market risk. However, because the application of a rooms revenue multiplier to determine value only considers revenue, the drastic increases in operating and fixed expenses that the industry has experienced over the past several years has resulted in downward pressure on multipliers and the recognition that these metrics may not return to pre-COVID levels in the near term. In other words, because many expenses, such as payroll, insurance, and property taxes, are higher and rising at a faster pace than revenues, a hotel may be valued at a lower multiplier because of profitability challenges. In prior periods, the multiplier may have been higher given stronger profitability levels or more availability of debt at a lower cost.

On the surface, the rooms revenue multiplier is a very simple concept, but determining the most applicable multiplier for a hotel is a thorough process that must consider all aspects of the real estate and operation. While not perfect, the RRM metric is helpful for owner-operated hotels with unusual accounting or expense histories.

The direct capitalization approach considers both revenues and expenses, providing a clearer picture of profitability. In addition, cap rates are more sensitive to market conditions and can help investors assess the risk associated with a property. Generally, lower cap rates indicate lower risk and higher demand, while higher cap rates suggest higher risk and potentially higher returns.

In any appraisal, multiple approaches to value are used, and the direct capitalization approach and rooms revenue multiplier are only two. A third approach under income capitalization is the discounted cash flow analysis, which considers multiple years of cash flows (and could be examined in its own article). In nearly all appraisals that are completed for limited-service hotels at **U.S. Hotel Appraisals** and HVS, all three valuation approaches under the income capitalization approach are considered (direct capitalization, rooms revenue multiplier, and discounted cash flow analysis). For more information on discount rates and equity yields, as well as other valuation metrics, **reach out directly to Katy**.

U.S. Hotel Appraisals and HVS specialize in appraisals for limited-service hotels. We complete thousands of assignments each year, with limited-service hotels being the subject of roughly half. The extensive internal database at our fingertips is unprecedented in this industry. We pride ourselves on concise, credible, and cost-effective appraisals to meet a variety of clients' needs and price points.

Contact Katy Black, MAI, at **** or +1 (970) 305-2229 with any of your hospitality appraisal or consulting needs. Katy holds permanent commercial appraisal licenses in Colorado, Arizona, California, Utah, Wyoming, Montana, and New Mexico, with the ability to obtain reciprocal licenses in all 50 states and all U.S. territories.

About Katy Black, MAI

Katy Black, MAI, is the Managing Director and Leader of the consulting and valuation practice of the Denver office. She is an appraisal and consulting expert in the lodging markets throughout the Western U.S. Since joining HVS in 2013, Katy has gained diverse experience spanning limited-service motels, city-center hotels, luxury assets, golf resorts, and mixed-use developments, as well as resort-residential and rental-management programs. She specializes in high-end, complex resorts and has provided valuation and consulting services for gaming assets and large hotel portfolios. In addition, Katy has worked extensively on unique lodging properties, such as glamping resorts, casino hotels, hostels, and waterpark resorts. Katy graduated from the University of Delaware with an honors BS in Hotel, Restaurant, and Institutional Management. She also earned an MS in Accounting from the University of Akron. She is a state-certified general appraiser and a Designated Member of the Appraisal Institute (MAI). Contact Katy at (970) 305-2229 or .